86-1006

Supreme Court, U.S.
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No. 86-

IN THE

Supreme Court of the United States

October Term, 1986

MARATHON OIL COMPANY,
an Ohio corporation,

Petitioner,

v.

UNITED STATES OF AMERICA; UNITED STATES DEPARTMENT OF THE INTERIOR; DONALD HODEL, Secretary of the Interior; ESTHER WUNNICKE, Commissioner of the Department of Natural Resources, State of Alaska; COOK INLET REGION, INC., an Alaska corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

The Mineral Leasing Act of 1920 (MLA) instructs the Secretary of the Interior to collect a 12½% *royalty* on oil and gas production removed or sold from federal leases. The Secretary's collection agency, the Minerals Management Service (MMS), has through the process of informal adjudication asserted authority to collect not a royalty but a share of downstream manufacturing and transportation profits from Marathon's sale of Liquefied Natural Gas (LNG) in Japan, which is manufactured from natural gas produced on Marathon's federal leases in Alaska. The Court of Appeals deferred to the agency's novel interpretation of the statutory term "royalty" without determining that the statute was ambiguous.

The questions presented are:

1. Whether the Court of Appeals erred in deferring to an agency interpretation of a statutory term without finding the statute ambiguous and without examining Congress' intent in using a term having an established commercial meaning.

2. Whether the Court of Appeals erred in deferring uncritically to an agency's statutory interpretation without examining the reliability of the interpretation when it was unprecedented, unexplained, unrelated to the agency's expertise, and contrary to fifty years of prior agency practice.

LIST OF PARTIES AND RULE 28.1 LIST

The names of all the parties to the proceeding in the Ninth Circuit are listed in the caption of this petition.[1]

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[1] Because Petitioner is a corporation, it submits the following list of related companies pursuant to Supreme Court Rule 28.1. Petitioner Marathon Oil Company is a wholly owned subsidiary of USX Corporation, and portions of its business are operated as separate, wholly owned subsidiaries of USX Corporation. In addition to its wholly owned subsidiaries, Marathon Oil Company is affiliated with the following entities:

Arctic LNG Transportation Company
Badger Pipe Line Company
City Point Oil Terminal, Inc.
CLAM Petroleum Company
Cook Inlet Pipe Line Company
Deutsche Transalpine Olleitung GmbH
Explorer Pipeline Company
Gravecap, Inc.
Green Bay Terminal Corporation
Kenai LNG Corporation
LOCAP, Inc.
LOOP Inc.
Oasis Oil Company of Libya, Inc.
Oil Insurance Limited
Petroleum Terminals, Inc.
Pilot Oil Corporation
Platte Pipe Line Company
Polar LNG Shipping Corporation
Russell Stewart Oil Co.
Societa Italiana Per L'Oleodotto Transalpino, S.p.A.
Transalpine Finance Holdings S.A.
Transalpine Olleitung in Osterreich Gmbh
West Shore Pipe Line Company
Wolverine Pipe Line Company

In addition to subsidiaries which are wholly owned, including Marathon, USX Corporation is affiliated with the following entities:

Athlone Prospecting & Development Corporation, Ltd.
First National Bank (Albion, Pa.)
Companhia Meridional de Mineracao
Alfa Produtos Metalurgicos, Ltda.
ITW-Mapri (51% owned by Alfa Produtos)
Mecania Walsywa, Ltda.
Companhia Siderugica Paulista "Cosipa"
Merinda Mineracao
Mineracao Buritirama Ltda.
Mineracao Carajas, Ltda.
Mineracao Maraba, Ltda.
Mineracao Xingu, Ltda.
Termerid Mineracao, S.A.
Torremco Soc. Min. E. Com. Ltda.
Deepsea Ventures, Inc.
Ocean Mining Associates
FHS Stablverformung GmbH
FHS Automotive Parts Manufacturing Ltd.
Industria de Tubos y Perfiles, S.A. (Intuperas)
Minerales Ordaz C.A.
Les Entreprises du Lac Lucault Inc.
Sidbee-Normines, Inc.
U.S. Steel France
Zierust Chrome Mines, Limited
USS Technology (Japan), Ltd.
ACE Holdings, Ltd.
Adela Investment Company, S.A.
Altos Hornos de Viscaya, S.A. (AHV)
Associated Ore & Metal Corporation, Ltd.
Avsteel SWA, Ltd.
Blue Grass Phosphate Company
Chrome Deposit Corp. (Court Holdings J.V.)
Kappa Mining & Prospecting Co., Ltd.
La Pointe Iron Company
Oresteel Investments (Proprietary), Ltd.
P. T. Pacific Wikkel Indonesia
Sigma Mining & Prospecting Co. (Pty.) Ltd.
Societe Des Mines De Fer De Guinea Pour L'Exploitation Des Monta Nimba (Mifergui Nimba)
Tilden Iron Mining Company
West Union Canal Company, The
Bartow Chemical Products
Century III Associates
Fort Meade Chemical Products
Double Eagle Steel Coating Co.
Live Oak Uranium Operations
Rockland Joint Venture
BMI Company
Tenneco/USS Chemicals Joint Venture
Compagnie Miniere de l'Ogooue (Comilog)
Feralloys, Ltd.
Assoc. Manganese Mines of South Africa, Ltd.
Prieska Cooper Mines (Pty.) Ltd.
Terminoss Acciai Inossidabili S.p.A.
Zuari Argo Chemicals Ltd.
USS-Posco Industries
Navios Shipping Corp.
USS-OCF-W&M Joint Venture

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The petitioner, Marathon Oil Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled proceeding on July 24, 1986.

OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit was originally reported at 794 F.2d 1461, and then withdrawn from West's bound volume because on July 25, 1986 the Court of Appeals temporarily withdrew the opinion from publication. The opinion is reprinted in Appendix A, at p. 2a.

The opinion of the District Court for the District of Alaska is reported at 604 F. Supp. 1375, and is reprinted in Appendix B-2, at p. 22a. The District Court's order of May 1, 1985 enjoining Marathon to comply with MMS's orders is unpublished, and is reprinted in Appendix B-1, at p. 18a.

JURISDICTION

The Ninth Circuit entered its opinion and judgment on July 24, 1986. Appendix A, at p. 2a. Petitioner filed a petition for rehearing and suggestion of rehearing *en banc,* and the Ninth Circuit has requested the United States to submit a response. *See Marathon v. United States,* No. 85-3800, *Order* (9th Cir. September 30, 1986), reprinted in Appendix D-5, at p. 80a. The petition for rehearing is still pending but its pendency does not affect Petitioner's time in which to seek certiorari because the petition was deemed to be late, though ordered filed. *See* Supreme Court R. 20.4.

On October 3, 1986, Justice O'Connor extended the time for filing this petition for writ of certiorari to and including December 21, 1986.

Petitioner invokes the jurisdiction of this Court to review the judgment of the Ninth Circuit under 28 U.S.C. § 1254(1).

STATUTE AND REGULATION INVOLVED

Excerpt from the Mineral Leasing Act of 1920, 30 U.S.C. § 226(a),(c).

§ 226. Lease of oil and gas lands

(a). All lands subject to disposition under this chapter which are known or believed to contain oil or gas deposits may be leased by the Secretary.

* * * *

(c). If the lands to be leased are not subject to leasing under subsection (b) of this section, the person first making application for the lease who is qualified to hold a lease under this chapter shall be entitled to a lease of such lands without competitive bidding. Such leases shall be conditioned upon the payment by the lessee of a royalty of 12½ per centum in amount or value of the production removed or sold from the lease.

30 C.F.R. § 206.103

§ 206.103 Value basis for computing royalties.

The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. Under no circumstances shall the value of production of any of said substances for the purposes of computing royalty be deemed to be less than the gross proceeds accruing to the lessee from the sale thereof or less than the value computed on such reasonable unit value as shall have been determined by the Secretary. In the absence of good reason to the contrary, value computed on the basis of the highest price per barrel, thousand cubic feet, or gallon paid or offered at the time of production in a fair and open market for the major portion of like quality oil, gas, or other products produced and sold from the field or area where the leased lands are situated will be considered to be a reasonable value.

STATEMENT OF THE CASE

This case arises over the Minerals Management Service's (MMS) 1983 reinterpretation of the Mineral Leasing Act of 1920 (MLA) and the royalty clause in thirty-year old producing oil and gas leases located in the Kenai Field in Alaska. Marathon owns a 50% interest in the leases, which produce natural gas, some of which is used by Marathon in the manufacture of Liquefied Natural Gas (LNG) that is shipped from Alaska in specially designed and constructed tankers and sold in Japan for heating, cooling and fuel uses under a long-term contract.[2] Marathon also sells natural gas from the leases at the wells to other purchasers under arms-length contracts.

In accordance with the MLA, 30 U.S.C. § 226(c) (1982), the federal leases provide that "royalty" shall be paid in the amount of 12½% on "production removed or sold from the leased lands" computed in accordance with the operating regulations now codified as 30 C.F.R. § 206.103 (1986). That regulation has remained substantially the same during the three decades the leases have been in effect.

During the first 11 years of Marathon's LNG project, the Department of the Interior (DOI) calculated the value of the feedstock gas on the basis of the highest price paid for natural gas under arms-length sales in the same field. Thereafter pursuant to a 1981 settlement agreement with Marathon, DOI

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[2] Marathon has contended from the beginning that LNG is not natural gas and submitted an expert's affidavit to that effect to the district judge. The Department of the Interior's regulations define gas as "any fluid, either combustible or noncombustible, which is produced in a natural state from the earth and which maintains a gaseous or rarefied state at ordinary temperatures and pressure conditions." 43 C.F.R. § 3000.0-5(a). LNG is not only liquid but has refrigerant qualities and can be conveniently stored above ground, both of which properties also distinguish it from natural gas. These points, and the chemical differences between LNG and natural gas, were made in the *amicus* brief of the American Petroleum Institute in the Ninth Circuit.

valued such gas on the basis of one of the higher values prevailing in the entire Cook Inlet. At issue in this case are MMS orders that abandon the settlement agreement and establish a netback valuation methodology that values the government's royalty on natural gas produced in Alaska at the price of LNG sold in Japan less some cost allowances. These orders change the government's leasehold interest from the royalty interest provided for in the MLA to what the Secretary concedes is a profit-sharing interest.[3] This methodology arrogates to the government — risk free — a substantial portion of Marathon's downstream manufacturing and trans-Pacific transportation profits. The netback orders thus adversely affect numerous federal oil and gas lessees who have invested millions of dollars in plants and equipment to manufacture gas produced from federal leases into other products.

Petitioner commenced this action in the United States District Court for the District of Alaska seeking a declaration that MMS had exceeded its authority in ordering Petitioner to utilize a netback formula to calculate the royalty owing on gas produced on Petitioner's oil and gas leases on federal land in Alaska. The District Court had subject matter jurisdiction over this action under 28 U.S.C. § 1331 because the case presents a federal question. The District Court granted the federal defendants' motion for summary judgment on February 20, 1985, *see Marathon Oil Co. v. United States,* 604 F. Supp. 1375 (D. Alaska 1985), Appendix B-2, at p. 22a, and permanently enjoined Petitioner to comply with the MMS Orders on May 1,

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[3] Marathon complains that any royalty valuation methodology which has as its starting point the price which Marathon receives in Japan will have the effect of permitting the government to share in Marathon's "entrepreneurial profits" which are purportedly the result of the efforts which Marathon put forth, and the risks which it ran, in participating in the development of the Japanese LNG market. That consequence, however, was foreordained by the gross proceeds provision of the regulation which was in effect when Marathon's leases were issued and at all times since.

Brief for the United States of America, Appellee, at 33 (filed in October 1985 in *Marathon v. United States,* No. 85-3800 (9th Cir.)).

1985, *see Marathon Oil Co. v. United States, Order,* No. A83-208 Civil (D. Alaska May 1, 1985), Appendix B-1, at p. 18a. Petitioner took an interlocutory appeal from the District Court's permanent injunction and award of summary judgment.

The Ninth Circuit's decision, which upheld the MMS orders, has implications beyond the validation of the agency's orders. The Ninth Circuit decision essentially abrogates the responsibility of the courts to enforce plainly expressed congressional intent when an administrative agency interprets a statute. The Ninth Circuit determined that it must defer to MMS' unprecedented interpretation of the statutory term "royalty," although the court found no ambiguity in the statutory language. Moreover, the court gave no consideration whatsoever to the reliability of the agency's determination. In so doing that court veered sharply from the principles of judicial review established in the decisions of this Court. Certiorari should be granted to correct the error in this case and to prevent such errors in the future.

IMPORTANCE OF THE CASE

Here the Department of the Interior has illegally claimed millions of dollars of Marathon's downstream manufacturing and transportation profits by excising the word "royalty" from the Mineral Leasing Act and substituting in its place the words "profit-sharing interest." This impermissible change in the statute by informal agency action affects not only Marathon's LNG manufacturing enterprise but threatens all federal oil and gas lessees who use oil or gas as feedstock for such manufactured products as plastics, fertilizer and refinery products. The case also raises several important issues of administrative law, which this Court should resolve in order to implement its holding in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984). Those issues are whether a court may defer to an agency statutory interpretation without first ascertaining whether the statutory terms are ambiguous so as to require interpretation and whether a court may ignore the reliability of an agency's interpretation when deferring to it.

REASONS FOR GRANTING THE WRIT

I.

THE COURT BELOW ERRED IN DEFERRING TO AN ERRONEOUS ADMINISTRATIVE INTERPRETATION OF AN UNAMBIGUOUS STATUTE.

The Ninth Circuit has invoked principles of deference to shirk its responsibility to review unlawful agency action and its duty to ensure agency compliance with a clear congressional mandate. The court resolved Marathon's contention that the agency's informal action was contrary to Congress' command in the Mineral Leasing Act of 1920, 30 U.S.C. § 226(c), to collect a "royalty," by simply deferring to the agency's interpretation of the statutory term, even though that interpretation was contrary to the plain meaning of the statute, the legislative history of the Act, longstanding agency interpretation of the Act and the relevant regulation, and ordinary commercial usage in the oil and gas industry. In electing to defer to the agency, the Ninth Circuit never analyzed whether the statute and legislative history were unclear. The Ninth Circuit simply stated:

> The agency's interpretation of the applicable statute is entitled to substantial deference, particularly if the agency is charged with administering the statutes. *See Chevron, U.S.A., Inc. v. National* [sic] *Resources Defense Council, Inc.*, 467 U.S. 837, 843-45 (1984).

Appendix A, at p. 10a.

In failing to inquire into Congress' intent as expressed in the words Congress chose and the reasons it gave, the Ninth Circuit has treated deference as an excuse for ignoring congressional intent. The influence of the decision thus extends far beyond the parties' royalty dispute because it affirms unlawful agency action, condones future agency disregard of congressional mandates, and adds to the confusion in the lower federal courts over when deference to agency legal interpretations is unwarranted.

A court reviewing an agency's construction of a statute must conduct a threshold inquiry into Congress' intent: "First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837, 842-43 (1984) (footnote omitted). Thus, in *Chevron,* this Court explicitly reaffirmed the line of cases holding that the "judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. . . . If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is the law and must be given effect." 467 U.S. at 843 n.9 (citing cases including *FEC v. Democratic Senatorial Campaign Committee,* 454 U.S. 27, 32 (1981) and *SEC v. Sloan,* 436 U.S. 103, 117-118 (1978)); *see also Chemical Manufacturers Ass'n v. Natural Resources Defense Council, Inc.,* 470 U.S. 116, 125 (1985). *Chevron* and subsequent decisions of this Court implicitly rejected the approach taken in some earlier cases that suggested that a court may defer to an agency's statutory interpretation without first examining congressional intent. *Compare Red Lion Broadcasting Co. v. FCC,* 395 U.S. 367, 381-82 (1969) and *Udall v. Tallman,* 380 U.S. 1, 16-17 (1965) *with Board of Governors v. Dimension Financial Corp.,* ____ U.S. ____, 106 S. Ct. 681, 686, 688-89 (1986); *United States v. Riverside Bayview Homes, Inc.,* ____ U.S. ____, 106 S. Ct. 455, 461 (1985); *Chemical Manufacturers Ass'n,* 470 U.S. at 125-26 (opinion of the Court) and 470 U.S. 134, 151-52 (Marshall, J., dissenting); *Young v. Community Nutrition Institute,* ____ U.S. ____, 106 S. Ct. 2360, 2367-68 (1986) (Stevens, J. dissenting). Specifically, and applicable here, this Court has refused to defer to an agency's interpretation of a statutory term when the agency's interpretation is contrary to the accepted commercial usage of

the term and nothing in the statute or legislative history indicated that Congress intended to deviate from ordinary commercial usage. *Dimension Financial Corp., supra,* 106 S. Ct. at 688 (rejecting agency interpretation of "commercial loan" because it was contrary to ordinary commercial usage of that term).

Consequently, in *Chevron* this Court gave effect to Congress' command in the Administrative Procedure Act that: "To the extent necessary to decision and when presented, *the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions,* and determine the meaning or applicability of the terms of an agency action." 5 U.S.C. § 706 (emphasis added).

The threshold requirement for deference in *Chevron* requires the reviewing court, when an agency interpretation of a statute is challenged, to analyze and explicitly find, as a matter of law, that the statute and legislative history are ambiguous on the disputed issue. This Court employs that process as a matter of course and should demand no less from the lower federal courts. The Ninth Circuit made no pretense of examining the text and legislative history of the MLA; instead it simply skipped the first step in the *Chevron* analysis and proceeded to endorse an erroneous agency interpretation of the Act.

If instead of skipping entirely an examination of the text and legislative history of the MLA, the Court of Appeals had carefully analyzed the statute and legislative history of the MLA as required by *Chevron,* it would have found the case to be analogous to *Board of Governors v. Dimension Financial Corp.,* ____ U.S. ____, 106 S. Ct. 681, 686, 688-89 (1986). The term Congress adopted, "royalty," has had an accepted commercial usage in the mining industry for several centuries, and Congress gave no indication in the MLA that it intended a different meaning to apply in federal oil and gas leases. On the contrary, Congress knew what royalty meant and intended to adopt the ordinary commercial meaning.

MLA was enacted in 1920, during an earlier era of administrative law when non-delegation was still the norm: Congress gave agencies specific instructions to carry out delegated tasks and left no room for the agencies to make new law or change old law through the guise of statutory interpretation. In the MLA, Congress instructed the Secretary of Interior to collect from federal lessees a "royalty of 12½ per centum in amount or value of the production removed or sold from the lease." 30 U.S.C. § 226(c). Congress' command was clear. The Government's interest in federal oil and gas leases is a *royalty* and it attaches to production of hydrocarbons as they are removed or sold from the lease. The government may elect to take its royalty in kind at the lease or in equivalent value, also at the lease. The plain meaning of the statute, as well as general oil and gas law, dictates that the boundaries of the leasehold establish the place where valuation takes place for all gas sold or otherwise removed from the lease. Thus the royalty payable on Alaska feedstock gas should not be calculated on the sales price of LNG in Japan.

Under general oil and gas law, it is well established that the value of gas, for royalty purposes, is based on market value at the wellhead. In *Wall v. United Gas Public Service Co.,* 178 La. 908, 152 So. 561 (1934), the Louisiana Supreme Court held that gas royalties must be calculated at the wellhead because this is when the lessee comes into possession of the gas. *See also Louisiana Land & Exploration Co. v. Donnelly,* 394 F.2d 273, 277 (5th Cir. 1968); *Patterson v. Texas Co.,* 131 F.2d 998, 1001 (5th Cir. 1942), *cert. denied,* 319 U.S. 761 (1943); *Wright v. Brush,* 115 F.2d 265, 267 (10th Cir. 1940); *Martin v. Glass,* 571 F. Supp. 1406, 1410 (N.D. Tex. 1983), *aff'd per curiam,* 736 F.2d 1524 (5th Cir. 1984); *Probst v. Ingram,* 373 P.2d 58, 61-62 (Okla. 1962).

The Department of the Interior had been consistently employing the standard industry usage of the term "royalty" prior to the time Congress amended the MLA in 1946 to

provide for a flat 12½% royalty for non-competitive leases instead of a variable royalty of "not less than" 12½%. On June 7, 1937, the Acting Secretary of Interior stated,

> Leases issued under [MLA] contemplate that a single royalty may be collected upon the value of the natural gas in the condition in which it comes from the well. . . . [He noted operating regulations that provided:] The Government does not wish to collect royalty on that part of the value which is derived from the cost of manufacturing, *inasmuch as the Government's equity is confined to the value of the raw material involved.*

Interpretation of Oil & Gas Regulations, 56 Interior Dec. 462, 462-63 (1937) (emphasis added).

In the mining industry, a royalty is a cost-free share of production. A net-profits interest is a share of profits from production after costs have been deducted. 5 E. Kuntz, *Law of Oil and Gas* §§ 63.1, 63.5 (1978); 2 H. Williams & C. Meyers, *Oil and Gas Law* § 424, at 438 (1985); *see also Cox v. United States,* 497 F.2d 348, 351 n.3 (4th Cir.) (net profits "represents a fractional share of the *profit* of the operating company" while a royalty is "a fractional share of the *minerals themselves as produced*" (emphasis added)), *cert. denied,* 419 U.S. 1047 (1974). Because a royalty interest is a fractional interest in raw production, as opposed to a share of net profits, a royalty owner may not attempt to recover a royalty payment which is based on the value of products manufactured from leasehold production. *Phillips Petroleum Co. v. Record,* 146 F.2d 485, 486 (5th Cir. 1944); Sneed, *Value of Lessor's Share of Production Where Gas Only is Produced,* 25 Tex. L. Rev. 641, 648, 650 (1947). Thus, a royalty does not entitle its owner to any part of the lessee's downstream manufacturing and transportation profits. It is a passive right to receive a portion of the production from a lease, either in kind or in value. *See* R. Hemingway, *The Law of Oil and Gas* § 2.5, at 52 (2d ed. 1983).

Congress specifically chose to retain the word royalty in 1946, aware of the Department of the Interior's and the oil and gas industry's unchanged definition of the term. If Congress had intended to grant the Government a net profits interest, it could and would have done so expressly in 1920, 1946, or subsequently. *See American Tobacco Co. v. Patterson,* 456 U.S. 63, 68 (1982) (legislative purpose is expressed by the ordinary meaning of words used). Where Congress has contemplated net profit sharing in lieu of a straight percentage royalty on the value of production, it has said so expressly. For example, in the Outer Continental Shelf Lands Act Amendments of 1978, 43 U.S.C. § 1337(a)(1)(D)-(F) (1982), Congress permitted the Department of the Interior to consider a variety of bidding systems, some of which expressly included net profit sharing elements, but Congress chose not to make comparable changes in the MLA for on-shore federal leases.

Despite Congress' use of the term "royalty," the MMS in 1983 ordered Marathon Oil Co. to begin paying a share of the profits from the sale in Japan of its manufactured product, LNG, as the "royalty" due under the leases. The Government has since admitted that it intended by this order to share in Marathon's downstream enterpreneurial profits. *See* footnote 3, *supra.* MMS thus chose an impermissible means for amending a statute — that of informal agency adjudication — rather than the constitutional means of changing a law through congressional action. As this Court explained in *Dimension Financial Corp.:* " The statute may be imperfect, but the Board has no power to correct flaws that it perceives in the statute it is empowered to administer. Its rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute." 106 S. Ct. at 689.

In sum, this Court's precedents require a threshold inquiry into the statute and legislative history prior to exercising deference to an agency's statutory interpretation. The Court of Appeals did not follow these precedents: it did not find the

statute's reference to "royalty" to be ambiguous, yet it chose to defer to the agency's interpretation of that statutory term anyway. Had the Ninth Circuit engaged in the proper inquiry it would have found a clear expression of congressional intent in the statute and legislative history. Consequently, the court's decision condones an erroneous interpretation of a statutory term that is of significant importance to all lessees of federal oil and gas lands. Equally important, the decision exacerbates the confusion in the lower federal courts about when deference to an agency's legal interpretation is appropriate; it creates the impression that courts can defer to agencies without first conducting an independent inquiry into Congress' intent.

This case is an appropriate vehicle for instructing the lower courts on the meaning of *Chevron* and the necessity of conscientiously applying the traditional threshold test of congressional intent. By reviewing the judgment below, the Court can also correct the specific error of the Ninth Circuit and protect Petitioner and the industry from unwarranted monetary claims.

II.

THE TRADITIONAL TESTS FOR RELIABILITY OF AGENCY INTERPRETATION WERE NOT APPLIED IN THIS CASE.

Even if the Court of Appeals had engaged in the threshold inquiry into Congress' intent and somehow concluded that the Mineral Leasing Act's reference to "royalty" was ambiguous, it still would have erred if it had deferred to the MMS' interpretation of this term because of the circumstances surrounding MMS' adoption of that interpretation. The Ninth Circuit's decision illustrates the lower federal courts' confusion since *Chevron;* in many cases the courts believe they *must* automatically defer to an agency on a question of law even though certain danger signals arising from the circumstances of the agency's interpretation counsel against such deference. *Chevron* did not overrule prior cases holding that the circumstances

of an agency's interpretation should affect the decision to defer. Yet the lower federal courts, including the Ninth Circuit in this case, have forgotten these cases in their rush to embrace the doctrine of deference. As Professor Byse has explained, "The question is not whether the agency's interpretation shall be 'considered' or 'taken into account.' The precise problem is the extent to which the agency's interpretation shall affect or control the court's interpretation." Byse, *Scope of Judicial Review in Informal Rulemaking*, 33 Ad. L. Rev. 183, 191 (1981). This Court should reaffirm and clarify, in light of *Chevron*, its cases addressing the circumstances in which an agency's legal interpretation may be unreliable. The instant case presents an excellent opportunity for such clarification because the agency's interpretation involves nearly all of the traditional factors that make an agency interpretation unreliable, yet the Ninth Circuit did not even address the issue.

A. Application Of The Criteria Of Reliability In This Case Indicates That Deference Was Unwarranted.

This Court has always deemed an agency's legal interpretation to be more or less reliable and worthy of deference depending on the circumstances. *See, e.g., Batterton v. Francis*, 432 U.S. 416, 424-26 & nn. 8-9 (1977). Those circumstances include: 1) the scope of Congress' delegation to the agency; 2) agency expertise; 3) the timing and consistency of the agency's interpretation; 4) the thoroughness of the agency's explanation for its position; 5) the authority of the agency official advancing the interpretation; and 6) the extent to which the agency's self-interest deprives it of objectivity.

First, when Congress gives an agency wide latitude to interpret a statute, set policy, and fill gaps in the statutory framework, a court should be more willing to defer to an

agency on a question of law.[4] Deference in this circumstance actually amounts to deference to Congress, which chose to delegate broad authority to the agency in the first place. Especially after *Chevron,* judicial review should be focused on the question whether the agency exercised legitimate law-making authority. In this case, Congress gave no discretion to the Secretary to redefine the term "royalty" and change a clearly expressed congressional mandate.

Second, when an agency has developed expertise in a specialized area its legal interpretation is more likely to be worthy of deference.[5] Royalty does not involve complex, technical matters. It is a dictionary term capable of straightforward application. No deference is due to MMS on grounds of expertise when no question of expertise is presented.

Third, the reliability of an agency's legal interpretation depends on its timing and consistency, *Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co.,* 463 U.S. 29 (1983). Indeed, this Court has rejected a DOI interpretation of the Mineral Leasing Act concerning distribution of oil and gas revenues in Alaska when the Department reversed and sought to abandon its prior longstanding interpretation of the Act. *See Watt v. Alaska,* 451 U.S. 259 (1981). The Court noted that "[t]he Department's contemporaneous construction carries persuasive weight" and that "[t]he

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[4] *See, e.g.,* Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 843-44, 865 (1984) (Court deferred to EPA on matters over which EPA had broad policymaking authority to fulfill Congress' mandate to clean up the nation's air).

[5] *See, e.g., Chemical Manufacturers Ass'n,* 470 U.S. at 125 (noting propriety of deference when statute is complex); *Chevron,* 467 U.S. at 844, 865 (deference proper when "full understanding of the force of the statutory policy in the given situation has depended upon more than ordinary knowledge respecting the matters subjected to agency regulations"; particular regard displayed for agency's interpretation on "technical and complex" matters); *cf. Dimension Financial Corp.,* 106 S. Ct. at 686 (no amount of agency expertise can vary a clear term in a statute).

Department's current interpretation, being in conflict with its initial position, is entitled to considerably less deference." *Id.* at 272-73. Again, the Ninth Circuit failed to consider this circumstance and ignored the fact that prior to this case DOI had never before attempted to define royalty to include a net profits interest.

Fourth, an agency's interpretation of a statute may be entitled to more or less deference depending on the thoroughness evident in the agency's explanation of its position.[6] An agency interpretation lacks power to persuade when it lacks a "concomitant exegesis of the statutory authority" supporting the agency's summary order. *SEC v. Sloan,* 436 U.S. 103, 118 (1978); *see also Motor Vehicle Mfrs. Ass'n,* 463 U.S. at 57 (rejecting agency decision changing course of policy because agency failed to "supply a reasoned analysis" for its decision and quoting *Greater Boston Television Corp. v. FCC,* 444 F.2d 841 (D.C. Cir. 1970)); *Community Nutrition Institute,* 106 S. Ct. 2366, 2368 n.3 (Stevens, J., dissenting) (deference not appropriate when agency never addressed in any detail the statutory authorization for the actions it has taken). An agency may not extend its regulatory authority by bootstrapping its way through a series of unexplained informal actions that exceed its statutory mandate. *SEC v. Sloan,* 436 U.S. at 118-19. Nevertheless, the Ninth Circuit ignored the fact that MMS has never advanced any legal justification for, or reasoned explanation of, the statutory interpretation of royalty adopted in its orders to Marathon.

Fifth, this Court has also held that a justification of an administrative interpretation of a statute is worthy of deference only if it is articulated by officials acting at the administrative

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[6] *See, e.g., Chevron,* 467 U.S. at 865 (noting that "the agency considered the matter in a detailed and reasoned fashion"); FEC v. Democratic Senatorial Campaign Committee, 454 U.S. 27, 37 (1981); SEC v. Sloan, 436 U.S. 103, 117-18 (1978).

level with authority to set agency policy; *post hoc* rationalizations developed by trial counsel during the course of litigation are not worthy of deference. *See, e.g., Investment Company Institute v. Camp*, 401 U.S. 617, 626-28 (1971). "It is the administrative official and not appellate counsel who possesses the expertise that can enlighten and rationalize the search for the meaning and intent of Congress." *Id.* at 628. Here the only support for MMS's net-back orders is counsel's *post hoc* rationalization for MMS' interpretation of a portion of the implementing regulation. Neither MMS nor its appellate counsel made any effort to square the net-back orders with the statute.

Finally, this Court has also refused, as a matter of Due Process, to permit a public official or administrative body to adjudicate a final result against a citizen when the agency is biased by its pecuniary interest in the outcome of the decision.[7] In upholding the agency, the Ninth Circuit took no account of MMS' pecuniary interest in the interpretation it advanced. MMS is a collection agency for the Treasury, whose revenues increased directly as a result of an unprecedented interpretation of the term "royalty."

Chevron did not overrule these cases setting forth the degree of judicial deference owed to an agency's statutory interpretation. An inquiry into the circumstances would have revealed that MMS' interpretation was quite unworthy of deference. Because the Ninth Circuit failed to carry out this inquiry it did not properly fulfill its responsibility, to the detriment of Marathon and the industry.

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[7] *See, e.g.*, Marshall v. Jerrico, 446 U.S. 238, 242-44 (1980); Withrow v. Larkin, 421 U.S. 35, 46-47, 57-58 (1975); Gibson v. Berryhill, 411 U.S. 564, 578-80 (1973) ("those with substantial pecuniary interest in legal proceedings should not adjudicate these disputes"); Ward v. Village of Monroeville, 409 U.S. 57, 60-62 (1972); In re Murchison, 349 U.S. 133, 136 (1955) ("no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome"); Tumey v. Ohio, 273 U.S. 510, 522-23, 532 (1927).

B. This Case Is An Appropriate Vehicle To Instruct The Lower Courts On The Continuing Need To Apply Reliability Criteria To Agency Interpretations As Well As To Correct The Particular Error By The Ninth Circuit.

Once a statute has been deemed ambiguous, most lower courts complacently bow to the agency's interpretation as being "reasonable," without considering whether the agency's interpretation is reliable. The usual result is that when an agency in informal action takes a position on a statute and a private party objects, the courts will accept the agency's position if Congress' language in the statute is imprecise. Revision of agency errors thus becomes possible only through the cumbersome process of legislative amendment.

On the other hand, a few courts have continued to apply this Court's traditional criteria for analyzing the reliability of an agency legal interpretation. *See, e.g., American Federation of Labor v. Donovan,* 757 F.2d 330, 341 (D.C. Cir. 1985) ("when an agency interprets a statute, courts employ, in effect, a sliding scale of deference, taking into account a variety of deference-related factors such as those enumerated in *Batterton v. Francis* [432 U.S. 416 (1977)]"); *but cf.* Starr, *Judicial Review in the Post-Chevron Era,* 3 Yale J. on Reg. 283, 291, 297 (1986) (the author of the *American Federation of Labor* decision argues that *Chevron* cast doubt on the decisions suggesting a sliding scale of review and thus raised "yet unanswered questions about its application"). One instance of a lower court's careful inquiry into the reliability of an agency interpretation after *Chevron* is *Center for Auto Safety v. Ruckelshaus,* 747 F.2d 1, 5-6 (D.C. Cir. 1984), in which the court rejected EPA's approval of General Motors' plan for compliance with the Clean Air Act through design of vehicles with reduced emissions of pollutants to offset vehicles whose emissions violated the Act. After examining various criteria of reliability including agency expertise, the scope of Congress' delegation, and the timing of the agency's interpretation, Judge Scalia concluded:

> The degree of deference appropriate here, therefore, is modest — no more than that thoughtful respect we should give to the views of the officers of another branch who have been officially presented with the issue and who, like us, have taken an oath to apply the law that Congress enacted. That is not enough to overcome what seems to us the clarity of the statutory analysis set forth above.

747 F.2d at 6 (citations omitted); *see also Mayburg v. Secretary,* 740 F.2d 100, 105-06 (1st Cir. 1984) (discussing factors that affect the reliability of agency legal interpretation).

The lower court decisions that continue to examine the reliability of an agency's statutory interpretation are the exception rather than the rule.[8] Most courts assume that all agency legal interpretations are equally reliable, or worse, do what the Ninth Circuit did here, collapse *Chevron's* two-step analysis into one step so that the entire inquiry is directed at one issue only — whether the agency's statutory interpretation was facially "reasonable."[9]

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[8] Of the more than 250 court of appeals cases specifically relying on *Chevron,* only about 24 attribute any significance to the circumstances justifying deference, and almost all of those cases do so only in passing.

[9] *See, e.g.,* Natural Resources Defense Council v. Thomas, __ F.2d __, Nos. 85-1294, 85-1296, Slip op. at 22, n.20 (D.C. Cir. Nov. 7, 1986) ("Indeed, the apparently separate *Chevron* searches for congressional clarity and agency reasonableness are often collapsible into one; a petitioner will lose on both *Chevron* strands when the agency rebuts a reasonable reading with a reasonable reading of its own."); Simmons v. ICC, 766 F.2d 1177, 1179 n.2 (7th Cir. 1985) (emphasis added) ("recent pronouncements from the Supreme Court indicate that, *without regard to questions of administrative expertise,* the judiciary should, as a matter of course, accord great weight to statutory interpretations rendered by the agency responsible for the statute's enforcement"), *cert. denied,* 106 S. Ct. 791 (1986); Mattox v. FTC, 752 F.2d 116, 123-24 (5th Cir. 1985) (court deemed irrelevant to deference analysis under *Chevron* an aggrieved party's challenge that an agency interpretation did not require agency expertise and that the agency had departed from its prior longstanding policy); Alcaraz v. Block, 746 F.2d 593, 606 (9th Cir. 1984) (collapsing deference analysis under *Chevron* into only one inquiry: whether agency interpretation is within the range of reasonable meanings of the words of the statute).

The instant case provides the Court with a prime opportunity to clarify the second step of the *Chevron* analysis. The Ninth Circuit chose, without analysis or explanation, to defer to the agency's legal interpretation, yet that interpretation is surrounded by circumstances that indicate unreliability. Those circumstances include: (1) congressional intent not to grant the Secretary policymaking authority over the nature of the Government's return from leasing federal lands for oil and gas development; (2) the absence of a technical issue on which the agency had expertise; (3) the inconsistency of the agency's interpretation with its prior rulings; (4) the total lack of any explanation, reasoned or otherwise, of why the agency could collect a net profits interest instead of a royalty; and (5) the pecuniary interest of the agency in the new interpretation it advanced.

In these circumstances, MMS's statutory interpretation deserved close scrutiny. The Ninth Circuit and many other courts, by omitting any analysis of the reliability of the agency interpretation to which they defer, are rubber stamping agency interpretations rather than enforcing congressional mandates.

CONCLUSION

For these reasons, this petition for certiorari should be granted. The Ninth Circuit's decision omits the fundamental first step of statutory analysis under *Chevron* and thus stands as a precedent for allowing an agency to make an unprecedented and erroneous legal interpretation of a statutory term with an accepted commercial usage, contrary to a clear congressional command. Moreover, the Ninth Circuit's decision fails to consider the reliability of the agency's interpretation. Consequently, this Court can, by reviewing this case, clarify an important rule of decision in administrative law on which most of the lower courts are confused or mistaken and which recurs in nearly every case involving judicial review of administrative action.

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Respectfully submitted,

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